Report on Diesel Fuel Price Hedging, FY 2011-2013

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Washington State Department of Transportation

Fuel Hedging in FY2011-2013

During the FY11-13 biennium, WSDOT ferries division initiated a hedging program for the purpose of stabilizing fuel expense.

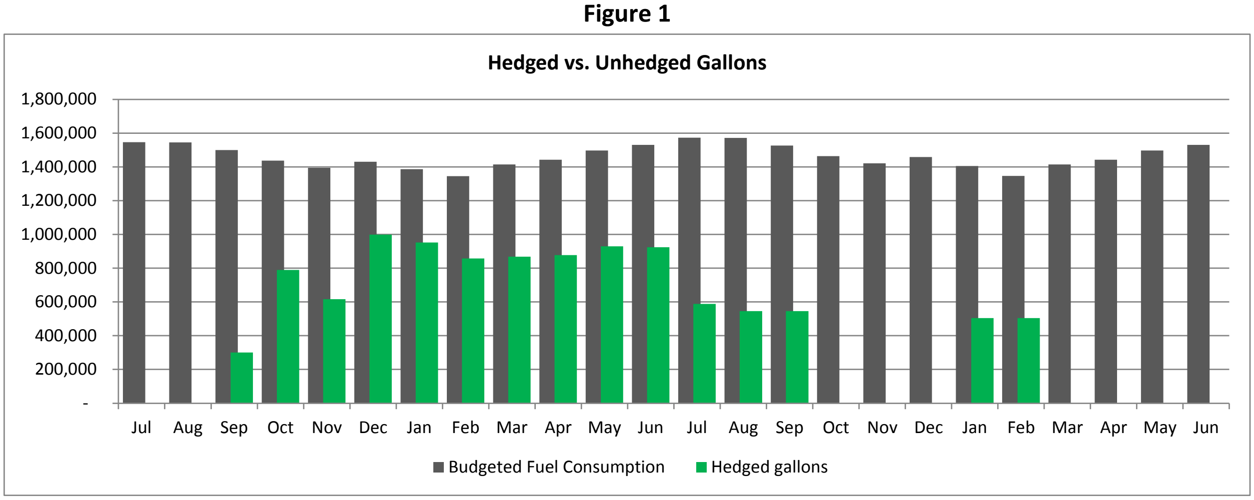
To this end, the department established a Fuel Hedging Committee to provide guidance, adopted a hedging policy, and used a hedging consultant to advise on the timing, quantities, and tenure of hedge contracts. The Fuel Hedging Committee consists of the Assistant Secretary for Finance and Planning, the Assistant Secretary for the Ferries Division, and a staff person from the Office of Financial Management. The committee meets on an ad hoc basis when a need arises to make a policy decision or to provide guidance on a particular hedge proposal. The committee is staffed by the Deputy Chief for Administration and Finance at WSF.

The hedging policy sets forth parameters within which hedges will be executed in terms of maximum quantities and length of contracts. The policy states that the purpose of the hedging program is to seek to decrease the volatility of fuel cost and increase the likelihood that actual net fuel cost will remain below the budgeted cost, not to save money. The policy is contained in Attachment A.

For this biennium, hedging was done directly through WSF's diesel supplier, Maxum, by locking in prices for diesel purchases to be made in future months.

Hedged fuel totaled 10.8 million gallons from July 1, 2011 through March 1, 2013, which is approximately 37 percent of all fuel purchased. During FY12, 46 percent of all consumption was hedged. Currently there are no hedges in place. Figure 1 shows hedged gallons compared to total consumption.

Figure 1



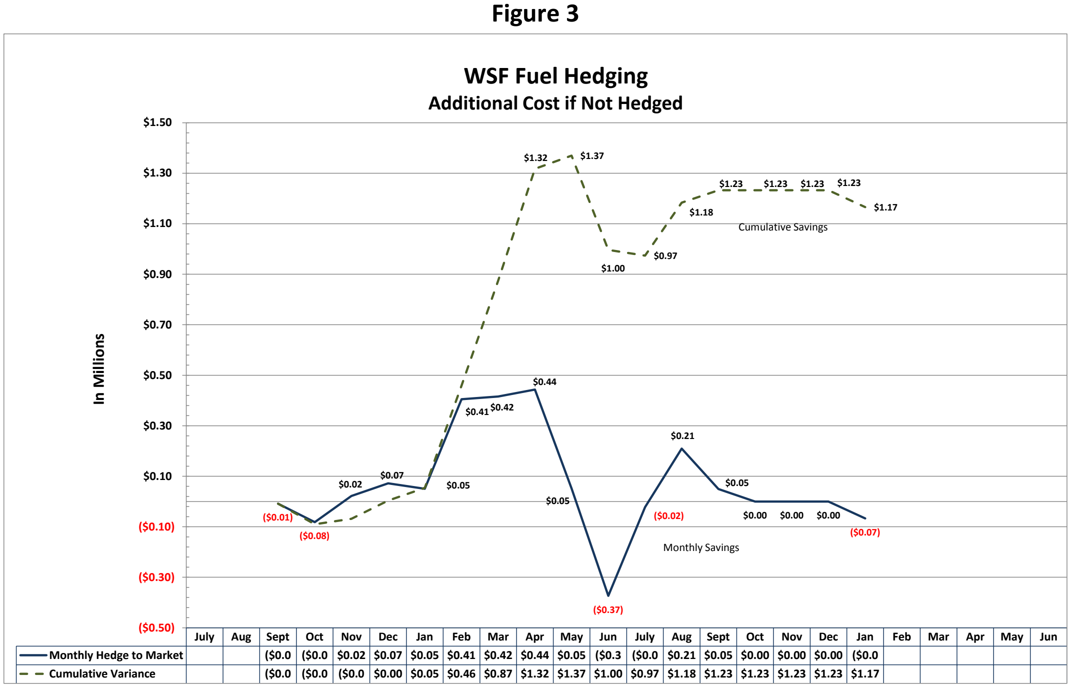
The hedging program had the effect of locking in prices that were below budget by approximately $3.2 million, including the cost of the hedging advisor. Figure 2 shows the results by hedge. The prices shown are before taxes and fees. The budgeted price before taxes and fees is $3.51 per gallon.

Figure 2

	Gallons	Average Price per Gallon	Savings compared to FY12 Budget	Savings compared to FY13 Budget	Savings compared to 2011-13 Budget
Hedge 1	**2,570,000**	**$3.232**	**$785,592**	**$0**	**$785,592**
Hedge 2	**1,428,000**	**$3.233**	**$330,217**	**$137,164**	**$467,381**
Hedge 3	**1,974,000**	**$3.253**	**$417,620**	**$180,752**	**$598,372**
Hedge 4	**1,890,000**	**$3.095**	**$641,981**	**$439,965**	**$1,081,946**
Hedge 5	**1,932,000**	**$3.493**	**$100,447**	**$0**	**$100,447**
Hedge 6	**1,008,000**	**$3.318**	**$0**	**$290,661**	**$290,661**
Total	**10,802,000**		**$2,275,856**	**$1,048,542**	**$3,324,398**
Fuel Hedging Advisor Contract			**$42,000**	**$50,000**	**$92,000**
Net Savings compared to Budget			**$2,233,856**	**$998,542**	**$3,232,398**

Hedging had the effect of stabilizing prices WSF paid for diesel. In addition, while it is not the purpose of the hedging program to save money or outsmart the market, WSF saved $1.1 million compared to the prices that would have paid without a hedging program. In Figure 3, the dashed line shows the cumulative amount that would have paid had hedges not been in place.

Figure 3



In future hedges, the plan is to use financial hedging to achieve the benefits of a hedging program at a lower cost. Diesel will still be purchased from our supplier, but hedging transactions will be conducted with a third party. Three financial hedge providers have been selected through a competitive procurement process. When master contracts are in place to do business with these parties, WSF will select a provider or providers by means of a competitive bid for each hedge transaction. By using financial hedging there is an expected average reduction in cost of 29 cents per gallon on hedged gallons, i.e. WSF will be able to hedge without an extra 29 cents built into future prices.

Washington State Department of Transportation

Signature on file: **Paula J. Hammond, P.E.** Secretary of Transportation

August 17, 2011
Date

Fuel Hedging Program

I. Introduction

A. Purpose

This Secretary's Executive Order informs employees how to administer fuel hedging in the Ferries Division.

B. Background

In 2011 the Washington State Legislature authorized the Washington State Department of Transportation (WSDOT) to enter into a distributor-controlled fuel hedging program for the biennium of 2011-13. The department is required to consult with the Department of General Administration's Office of State Procurement on strategies to reduce the overall cost of fuel, and mitigate the impact of market fluctuations and pressure on short-term and long-term fuel costs to the Ferries Division.

C. Definitions

Forward Pricing Period: The term of any fuel hedging contract.

Fuel Hedging: A contractual tool used to reduce exposure to volatile and potentially rising fuel costs. Fuel hedging results in price stability, not necessarily budget savings.

Fuel Hedging Program: The fuel price risk management program.

Hedge Ratio: The ratio of hedged fuel compared to total fuel purchases projected for a certain period of time.

Maximum Maturity: The maximum length of time that a fuel price contract may be extended.

II. Secretary's Executive Order

Employees are directed to establish and maintain a fuel hedging program with the primary purpose of managing price risk on fuel used by the Ferries Division. The fuel hedging program will be carried out by the Ferries Division, executing the appropriate transactions at the appropriate times and prices to create the desired effect within policy constraints.

The objectives of the fuel hedging program are:

- Decrease the volatility of fuel cost.
- Increase the likelihood that actual net fuel cost will remain below the budgeted cost.

Immediate cost savings is secondary to managing overall price risk.

Specific fuel hedging program strategies will include:

- Using price contracts with fuel distributors for quantities to be delivered at fixed times.
- Mitigating transaction timing risk by making numerous small volume transactions as opposed to large transactions at a single point in time.
- Continually monitoring the market and assessing program effectiveness.
- Addressing market opportunities and market risks based upon budget goals.

III. Policy

A. Program Administered by Ferries Division

The Assistant Secretary of Ferries Division is responsible for administration of the fuel hedging program.

B. Fuel Hedging Oversight Committee

The Fuel Hedging Oversight Committee shall meet at least quarterly, and includes the Assistant Secretary of Ferries Division, the Assistant Secretary of Strategic Planning and Finance Operations, and a representative from the Office of Financial Management (OFM). The committee reviews reports from Ferries Division staff and directs Ferries Division staff to provide information on program operations.

Ferries Division staff coordinates times, locations, and agendas for the committee. The committee reviews performance reports and policy and strategy recommendations from Ferries Division staff. The committee directs Ferries Division staff to provide additional information on program operations.

C. Fuel Hedging Program Advisor

The Fuel Hedging Program Advisor is selected by the department through a competitive process and will:

- Provide contracted services for a time period established by the department.
- Recommend an execution strategy.
- Generate monthly reports on the program’s status and results.
- Monitor the program and energy markets.

The costs associated with the program advisor consultant position will be budgeted and accounted for separately from fuel purchases, but will be considered as part of Ferries Division’s fuel budget.

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D. Maximum Hedge Ratio

Ferries Division fuel consumption is highly predictable and without significant variability over time within a given service, schedule, and fleet. Given this predictability, the maximum hedge ratio will be:

- Up to the first twelve months, on a rolling basis, a maximum of 95 percent of the forecasted consumption may be hedged. In addition, hedges will not exceed the forecasted monthly consumption level for any specific month.
- Between the thirteenth and twenty-fourth months, on a rolling basis, the volume of fuel hedged will not exceed 80 percent.
- The Oversight Committee may set lower limits.

E. Biodiesel Hedging

Hedge ratios may be adjusted if Ferries Division's planned percentage of biodiesel changes significantly from a level of five percent, or if the price correlation between diesel and biodiesel diverges more than five percent from its historical average.

F. Maximum Maturity

To allow the establishment of cost certainty in current and future budget periods, the maximum maturity of any contracts entered into in conjunction with the program is twenty-four months.

G. Physical Fuel Supply

The physical supply of fuel will continue according to the current process of Ferries Division under the General Administration contract. The physical supply price is based on the Oil Price Information Service (OPIS) index for ultra-low sulfur diesel for Tacoma and Anacortes, with taxes and other costs determined by the supply contract.

H. Reporting Responsibilities

Ferries Division staff, along with the Program Advisor, will

1. Generate for the Assistant Secretary of Ferries Division quarterly updates on the status and results of the Program. These updates will include:
    - The cost of fuel as delivered by the fuel supplier compared to prices that would have been available on the spot market.
    - Year to date and biennium to date performance of fuel expenses relative to the budget (including hedged purchases).
    - Any recommendations for changes in policy or strategy.
2. Compile yearly reports required per RCW 35.58.262. The reports will be distributed to the oversight committee prior to submittal to the state legislature

IV. Contact for More Information

For more information on the Fuel Hedging Program please contact the Deputy Chief for Administration and Finance of the Ferries Division at 206-515-3403.

V. References

- RCW 47.60.830 *Ferry system operation — Fuel purchasing strategies — Report*
  http://apps.leg.wa.gov/rcw/default.aspx?cite=47.60.830
- RCW 35.58.262, *Transportation Function – Fuel purchasing strategies – Reports.*
  http://apps.leg.wa.gov/rcw/default.aspx?cite=35.58.262

VI. Review and Update Requirements

When changes are necessary to update this document, inform the Assistant Secretary of Strategic Planning and Finance Operations.

The Assistant Secretary of Strategic Planning and Finance Operations periodically reviews this document and proposes updates to the Secretary of Transportation for approval.

Americans with Disabilities Act (ADA) Information
Materials can be provided in alternative formats by calling the ADA Compliance Manager at 360-705-7097. Persons who are deaf or hard of hearing may contact that number via the Washington Relay Service at 7-1-1.